

~~CONFIDENTIAL~~

Office Memorandum • UNITED STATES GOVERNMENT

TO : Chief, Industrial Division, ORR

DATE: 30 April 1959

FROM : Chief, Manufacturing Sectors Branch, D/I

SUBJECT: Reply to Comments on Project 30.2043 by Chief, Far East Branch, D/A.

1. General

Inasmuch as the machine building industry received the largest single share of industrial investment, it is a matter of some consequence as to whether these resources were well allocated. They should have been allocated (1) so as to maximize production; and (2) so as to provide the types of products which would most enhance Chinese Communist economic development. Because of its economic importance the machine building industry is bound to have important effects on the economy as a whole, even if some of its problems are peculiar.

Contrary to allegations, this report does not underestimate advances made by the Chinese Communists in machine building nor the vital role of Soviet aid in achieving these successes.* Moreover, the regime is given credit for being flexible in presenting new ideas.**

Why was it necessary for the regime to devise "new economic policies to meet new economic problems"? What are the problems and how did they come about? This report contends that a number of problems arose in the machine industry because of difficulties involved in applying the Soviet model and Soviet technology. We believe an understanding of the relationship between imbalances in Chinese economic growth and their attempt to duplicate the Soviet pattern of development is essential to an explanation of the drastic shifts in their development programs in 1957 and 1958. Apparently, the National Intelligence Estimate takes the same view. 1/**

On this point there is a fundamental divergence of outlook and opinion between ourselves and A/F. Their criticisms seem to indicate that they either deny or minimize the aforementioned cause and effect relationship. We believe this is a key issue that must be faced in a proper assessment of Chinese economic growth.

2. Detailed replies to A/F comments follow.

(A/F ltr para 1a)

The statement that "the place of 'prestige' and military security

* See pp. 1 (para 1), 12 (para D), 43 (para 2), 44 (para F).

** See p. 97.

*** Numbered source references may be found at the end of this memorandum.

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

SUBJECT: Reply to Comments on Project 30.2043 by Chief, Far East Branch, D/A.

But not at all times

elements in the development of the machine building industry is . . . unique" is somewhat surprising. There is abundant evidence that the Soviets have at times been carried away by "gigantomania". 2/ Since 1945 the history of underdeveloped countries, Communist and non-Communist alike, has been replete with cases of attempts to overreach capabilities. The tendency to apply the latest technology, however inappropriately, has even been discussed in academic literature as a kind of "investment demonstration effect." 3/ The criticism of our discussion of labor force problems appears to have no foundation whatever.*

(A/F ltr para 1b)

This has been dealt with in paragraph 1 of this memorandum.

(A/F ltr para 1c)

As to the inappropriateness of the Soviet planning model to Communist China and other underdeveloped countries, we may cite several economists who share our views. 5/ Moreover, the report adduces considerable evidence from Chinese Communist sources for this conclusion. The use of Western market concepts as bases for comparison has been far more refined than the criticism would indicate. The report distinguishes between investment priorities and investment criteria for the best achievement of predetermined economic goals. We have pointed out that there might have been more effective ways of satisfying Communist economic preferences.**

(A/F ltr para 3)

The statement that "the major aspects of the Soviet planning model -- the five-year plans, the priority of investment, the emphasis on widespread technical education, and so on -- have substantially more relevance to the problems of underdeveloped countries than the report concedes" is so broad as to be practically meaningless. The Indian plans, with their emphasis on the democratic approach, could fit into this definition. "Priority of investment" merely implies accelerated capital formation, whereas our report stresses the specific investment priorities which stem from Communist ideology.***

(A/F ltr - Attachment re p. 2)

We cannot agree that China's problems are merely the natural results

* See pp. 62-63, 79-80. The first source reference cited on p. 80 is an ORR study. 4/

** See p. 92.

*** See Foreword and pp. 5-6.

~~CONFIDENTIAL~~

~~CONFIDENTIAL~~

SUBJECT: Reply to Comments on Project 30.2043 by Chief, Far East Branch, D/A.

of rapid and forced growth. To be sure, some aspects of the disequilibrium would occur anywhere under these circumstances, but we maintain that the shifts in the Chinese Communist industrialization program in 1957-8 should be interpreted, at least in part, as departures from the Soviet pattern.*

(A/F ltr - Attachment re p. 3)

The "predilection for economizing labor" derives, of course, from the Marxian labor theory of value. This is further elaborated in the text.** On the relevance of Soviet experience to the problems of the underdeveloped countries of Asia see reply to A/F letter para 1c. The USSR in 1917 started from a better position, both from the standpoint of industrial base and from the standpoint of population pressure, than that of Communist China in 1949. 6/

(A/F ltr - Attachment re p. 6)

The implication that the Chinese did substantial independent thinking prior to 1956 on the means by which they would achieve industrialization appears to be untenable. In addition to the evidence cited in the report, it might also be pointed out that Chinese economic thought prior to 1949 contained only the vaguest outlines of a program for industrial development -- they were reasonably sure of what they would do with the "capitalists"! 7/

(A/F ltr - Attachment re p. 15)

Indications of some change in the Chinese Communists' approach to self-sufficiency is given elsewhere in the text.***

(A/F ltr - Attachment re p. 15-16)

The criticism completely misses the point of effectiveness of investment. Investment choices should emphasize not merely usefulness but relatively immediate usefulness in terms of enlarged capacity and output. That the Chinese themselves have criticized excessive non-productive investment would seem to indicate that they are aware of the importance of getting higher output per yuan invested. Their recent investment plans stress reliance on older cities with established "overhead" facilities, smaller-scale and shorter construction times.****

* See pp. 106-109.

** See pp. 92-93.

*** See pp. 100-102.

**** See p. 109.

~~CONFIDENTIAL~~

SUBJECT: Reply to Comments on Project 30.2043 by Chief, Far East
Branch, D/A.

(A/F ltr - Attachment re p. 17)

See previous paragraph. Obviously, defense considerations should have some influence on the location of new industries. There may also be compelling economic reasons for the choice of more costly inland sites. There are both military and economic disadvantages to the build-up of machine building bases away from vulnerable coastal areas.* Chinese Communist thinking now seems to be undergoing some change. Some of their former insistence on inland development has softened and a greater disposition to weigh benefits versus costs seems to be evident.

(A/F ltr - Attachment re p. 75)

This criticism is probably intended to apply also to the entire discussion of underutilization of capacity.** Short-term underutilization of capacity due to the workings of the "acceleration principle" was discussed in the case of textile machinery.*** However, on the whole such effects do not appear to be very prominent.

(A/F ltr - Attachment re p. 79)

We agree with A/F statement and see no conflict between it and what is said in the report.

 25X1A9a

* See p. 42.
** See pp. 63-79.
*** See p. 75.

~~CONFIDENTIAL~~

SUBJECT: Reply to Comments on Project 30.2043 by Chief, Far East Branch, D/A.

Source References:

1. CIA, ONE. NIE 13-2-59, 10 Feb 59, p. 3. S.
2. Fortune, July 1941.
3. A. O. Hirschman, "Economics and Investment Planning: Reflections Based on Experience in Colombia," in Massachusetts Institute of Technology, Center for International Studies, Investment Criteria and Economic Growth, (Economic Development Program publication B/55-10), p. 47n.
4. CIA/RR PR-133, The Industrial Labor Force of Communist China 1950-55, 30 Jan 56. p. 23ff. S.
5. Oleg Hoeffding, Soviet State Planning and Forced Industrialization as a Model for Asia. RAND Corporation P-1450, 4 Aug 58. U.
E. Stuart Kirby, "Economic Planning and Policy in Communist China," International Affairs, vol 34, no. 3 (Apr 58), p. 178. U.
6. Boorman, Eckstein, Mosely and Schwartz, Moscow-Peking Axis (New York: Harper, 1957), pp. 62-63.
7. Benjamin Schwartz et al, A Documentary History of Chinese Communism.

~~CONFIDENTIAL~~